

Comments by
Keith Bozarth, Executive Director
State of Wisconsin Investment Board
January 10, 2008

Senate Bill 351

By statute, SWIB is currently subject to the "prudent investor standard" but is also constrained by an over-riding list of permissible and impermissible investments. Senate Bill 351 makes the existing prudent investor standard the prevailing standard with respect to assets of the Wisconsin Retirement System (WRS), thereby overriding other constraints in current law. The bill, however, maintains the status quo with respect to other funds invested by SWIB, such as the State Investment Fund (SIF).

In making prudent investor the prevailing standard, SWIB's investment authority will match the authority under which most public pensions, all ERISA covered pensions, the Milwaukee City pension fund and investment trusts in general in Wisconsin operate. It also matches the recommended standard crafted by the National Conference of Commissioners on Uniform State Laws for the uniform act to govern public employee retirement systems.

The prudent investor standard in essence requires SWIB to:

1. Manage the money and property with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a similar capacity, with the same resources, and familiar with like matters, exercises in the conduct of an enterprise of a like character with like aims;
2. Diversify investments in order to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so, considering each trust's or fund's portfolio as a whole at any point in time; and
3. Administer assets of each trust or fund solely for the purpose of ensuring the fulfillment of the purpose of the trust or fund at a reasonable cost and not for any other reason.

There are several reasons why this change is needed. The current statutes provide a complicated and limited menu that can keep SWIB from using prudent, profitable investment approaches. Some examples include:

- Restrictions on international investments. The law currently limits international investments to 25% of the WRS' assets. But US companies only account for 45% of potential companies worldwide in which SWIB might invest. Also, with globalization, the lines are blurring as to what is a US or non-US company.

- Currency management. Particularly with the weakened dollar, SWIB needs to be able to manage currency. If SWIB currently thinks a currency is overvalued and will decline, it cannot take advantage of the information it has by shorting a given currency in order to control the risk and take advantage of a decline in the currency.
- Taking full advantage of negative as well as positive information about companies. For example, a strategy for equities is referred to as a 130/30 approach. This allows a manager to short certain companies that are believed to be overvalued while overweighting by an equal amount companies that are expected to outperform expectations.

The investment world is changing rapidly, and SWIB must be able to evaluate and act on those changes if it intends to remain a competitive institutional investor. The prudent investor standard allows SWIB to consider all prudent opportunities that will arise in the future. To quote from the prominent investment organization, Russell Investments, "Within four years, at least \$1 trillion of today's defined benefit pension assets will be invested in products that don't yet exist." It is not possible to anticipate the various permutations that may take, but a prudent investor is required to consider all options as they arise.

Why is SWIB seeking this change in the law now? Wisconsin's law, like that of many other states, has evolved since the days of bond-only pension portfolios. Prudent investor is the logical and predominant culmination of the evolution. SWIB's Board and staff began to review the possible change more than two years ago because of the restrictions listed above and the changing investment world. Dave Mills, my predecessor, outlined a proposal for the SWIB Board. The current proposal is the culmination of that process.

Although SB 351 will change SWIB's investment authority, it will not lessen SWIB's accountability to the Legislature, members of the WRS or the public. The Legislature's current oversight and monitoring mechanisms will continue to provide a strong structure to assure that SWIB carefully exercises its prudent investment authority. The prudent investor standard itself makes SWIB trustees and staff legally accountable for investing the assets solely for the benefit of the members of the retirement system, exercising the diligence, care and loyalty that a person familiar with institutional investing would use.

As a part of that process, SWIB will continue to methodically follow procedures and practices established over the years when making investment decisions. These practices include:

- The Board, with staff and outside consultant help, establishes an "asset allocation" that defines the asset classes in which SWIB will and will not invest.
- SWIB trustees adopt Investment Policies, Objectives and Guidelines that set the overall policies for investing the assets under SWIB's

management. The guidelines and any amendments to them are filed with the Legislature.

- The Board establishes a benchmark for each portfolio as a basis for measuring risk and return, based upon recommendations by an investment consultant. Performance is tracked and publicly reported to the Board and made available to the public on a monthly and quarterly basis.
- Each individual portfolio has a set of guidelines that establishes acceptable approaches and limits. The guidelines are approved after review by a multi-disciplinary Investment Committee of SWIB staff in public meetings.
- The Compliance Committee, chartered by the Trustees, monitors compliance with the investment policies and portfolio guidelines. Its meetings are open.
- Three internal staff auditors assist the Compliance Committee as well as the Audit Committee of the SWIB Board. The staff position of Internal Audit Director is required by state law and reports to the trustees through the Board's Audit Committee.
- The Legislative Audit Bureau (LAB) conducts annual financial audits and biennial program audits of SWIB.
- The SWIB trustees have established an Audit Committee -- composed of four trustees, the LAB Director and the State Comptroller -- that works with the Internal Audit Director and the LAB.
- Finally, SWIB files multiple public reports concerning its operations with the Legislature.

SB 351 will subject SWIB to the prudent investor standard -- the highest standard to which the majority of other pension funds and trustees are held. Although enactment of SB 351 will allow SWIB to remain competitive in the marketplace by being able to explore other types of investments, it will not result in a major shift in philosophy or practice. SWIB's business will remain investing primarily in stocks and bonds with the goal of earning sufficient returns to provide financial security for WRS members and control costs for taxpayers.



Testimony of

THE WISCONSIN RETIRED EDUCATORS' ASSOCIATION (WREA)

Arnold Chandler, WREA Legislative Chair

Leigh Roberts, WREA Research and Monitoring Legislative Chair

Jane Elmer, WREA Executive Director

Senate Committee on Veterans and Military Affairs,

Biotechnology and Financial Institutions

Thursday, January 10, 2008, 1:00 p.m.

330 Southwest, State Capitol

RE: WREA's Support for SB 351—Prudent Investor Legislation

Senator Sullivan and members of the Committee:

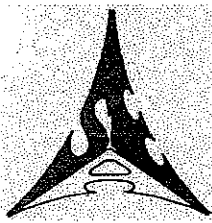
I am Arnold Chandler, Chair of WREA's Legislative Committee, and I am here today speaking on behalf of WREA's nearly 13,000 members. Thank you for giving us this opportunity to comment on the Prudent Investor Legislation.

WREA represents a major annuitant group, however, throughout WREA's 56-year history, we have maintained a broader focus, that being the long term integrity of the pension fund.

WREA supports SB 351 for the following reasons:

- ▶ The prudent investor standard is the HIGHEST standard applied in the industry.
- ▶ This legislation will allow State of Wisconsin Investment Board (SWIB) investors more flexibility to use additional investment strategies important to the future of the fund.
- ▶ WREA recognizes that diversification and investing for the long term are critical to the fund.
- ▶ We also recognize the importance of maintaining the appropriate investment standards, guidelines and policies that are currently in place in Wisconsin.
- ▶ WREA respects the expertise of the SWIB Board and Staff and values the good work they perform for the retirement fund and the state of Wisconsin.
- ▶ We are proud that Wisconsin has one of the best, if not the best, pension funds in the country. WREA wants SWIB to continue to be a leader and wants the best returns possible to the fund.

Thank you again for the opportunity to testify and for considering WREA's position on this important matter.



State Engineering Association
4510 Regent Street
Madison, WI 53705-4963

(608)233-4696
(608)233-6766 FAX
www.wisea.org

**Testimony to
The Assembly Committee on Financial Institutions
and
The Senate Committee on Veterans and Military Affairs, Biotechnology and Financial
Institutions**

**AB 623 and SB 351
Investments and Operations of the State of Wisconsin Investment Board**

January 10, 2008

My name is Gretchen Wheat. I am a member of the State Engineering Association (SEA), the collective bargaining unit representing state employees in professional occupations related to engineering.

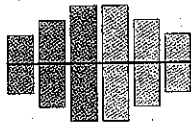
This testimony is submitted on behalf of SEA in support of AB 623 and SB 351.

SEA supports removing current limitations that require the State of Wisconsin Investment Board (SWIB) to invest only in specific classes of investments enumerated by statute. SWIB has performed well, and the changes proposed by AB 623 and SB 351 are necessary for SWIB to modernize its investments and further improve the management of the public employee trust fund.

SEA also supports the language in AB 623 and SB 351 to clarify that SWIB's statutory standard of responsibility does not apply in cases where another governing body (the building commission) has separate authority and directs the investment of certain public funds, even though SWIB subsequently implements the investment.

SEA is an independent bargaining unit, and is operated by the association membership. I am here as a member of SEA and as a state employee invested in the public employee trust fund. I am engineer employed by the Wisconsin Department of Natural Resources.

Please contact SEA if you have questions or would like to discuss these issues further.



Northern Capital Management, LLC
Growth Investment Advisors

STEPHEN L. HAWK, PhD
CHAIRMAN
CHIEF EXECUTIVE OFFICER

January 7, 2008

Senator Jim Sullivan
Room 15South
State Capitol
P.O. Box 7882
Madison, WI 53707

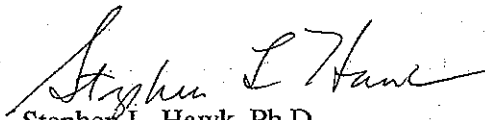
Dear Senator Sullivan,

I am writing to ask for your support for the proposed legislation to revise the rules which govern the manner in which the State of Wisconsin Investment Board is allowed to manage the retirement funds entrusted to their supervision. I consider the existing set of guidelines under which they must operate to be archaic in nature and completely at odds to the existing body of knowledge regarding sound investment practice. The existing guidelines are the product of a long history of perhaps well intentioned but simplistic solutions to perceived short term areas of risk and/or self interest and as such make it difficult to formulate an investment policy for the retirement funds that has a comprehensive perspective. In my opinion the proposed legislation accurately reflects the best of practices in current investment thinking which is critical to prudent and productive investment given the complexities of today's market place.

My basis for writing to you is the more than 40 years of experience I have had in the investment world. I received my BBA, MBA and Ph.D. degrees in Finance from the University of Wisconsin - Madison. I joined the faculty at UW Madison in 1967 and became Chairman of the Finance Department in the School of Business. While at the University I served as a consultant to the Board of Regents for their endowment portfolio and founded the Applied Security Analysis Program (www.bus.wisc.edu/asap/)(funded by the Brittingham Foundation) in 1970. I currently am the Chairman and CEO of Northern Capital Management, LLC, an independent investment management firm located in Madison founded in 1979.

I have carefully reviewed this proposed legislation and would be more than pleased to discuss it with you or your committee at your convenience. Thank you for your consideration of this matter.

Sincerely,


Stephen L. Hawk, Ph.D.
Chairman and CEO

cc: Lorrie Keating Heinemann



RBC
Dain Rauscher

The Schilffarth - Schnoll Group

Richard A. Schilffarth
Senior Vice President - Financial Consultant
1000 N. Water Street, Suite 1500
Milwaukee, WI 53202
414-347-7105 • 414-347-7120 Fax
800-933-3246 Toll Free
www.rbcdain.com
dick.schilffarth@rbcdain.com

December 6, 2007

Senator Jim Sullivan
Room 15South
State Capitol
P.O. Box 7882
Madison, WI 53707

Dear Senator Sullivan,

I would like you and your committee on Veterans and Military Affairs, Biotechnology and Financial Institutions (a curious group of unlike fellows) to look favorably on the legislation to revise the security investing rules governing the State of Wisconsin Investment Board (SWIB). I have personally reviewed the legislation and find it consistent with governing legislation covering like funds. Today's market place is too complex, too diverse and too broad to try and regulate what individual issues a fund may buy. It is much better from both the investment point of view and establishment of individual responsibility to bond the investment staff and board to broad fiduciary standards.

I believe I am competent to make that judgment. In 1974, I created the investment consulting concept, in 1975 developed the wrap fee and wrap account (now called Separately Managed Accounts or SMA), from 1983 to 1997 we created the managed account programs for most of the national and regional brokerage firms. During that same time frame we created investment management programs for many investment management companies including developing the separately managed account program for Sir John Templeton. In 2005 the industry association presented me with their Pioneer Award.

If you would like, I would be available to appear before your committee on this bill.

Sincerely,

Richard A. Schilffarth

Cc: Gail Hansen

Senator Jim Sullivan

Chairman, Senate Committee on Veterans, Military Affairs, Biotechnology and Financial Institutions

15 South, State Capitol

Madison, WI 53707

Dear Chairman Sullivan:

Thank you for the opportunity to comment on SB 351. As you may know, I served as Executive Director of the State of Wisconsin Investment Board (SWIB) from the fall of 2003 until May of 2007. Given my past tenure with SWIB and familiarity with the financial markets, I felt this brief letter might help you and other Committee members to better understand the background of the proposed legislation. In addition, I want you to know that I fully support the bill and encourage your Committee to act favorably on it.

During my first full year (2004) at SWIB it became apparent to me that the changing nature of the financial markets would require a modernization of Wisconsin's statutes if SWIB were to continue to be the successful public institutional investor that legislators, members and citizens all expected us to be. In the two decades since SWIB's statutes had seen major revisions to its investment authority, a sea change had occurred in the investment marketplace and other institutional investors, both public and private, had become better equipped than SWIB to take advantage of market opportunities and tools used to manage risk. In 2005 we began discussion with the Board's Strategic Planning Committee about the changes in the financial markets, the rationale for proposed statutory revisions and the process that SWIB should follow.

Beginning in 2006, staff began talking with member groups and individual legislators in an effort to educate them about the desired changes. However, our priority was to secure passage of the biennial budget bill which contained important provisions unrelated to SWIB's investment authority (provisions that were subsequently enacted). We also concluded that it could be helpful to the Board, legislators, and retirement system advocates to have an independent review of SWIB's authority and needs conducted by a nationally respected governance consultant. That consultant, Ennis Knupp, completed its work in 2007, confirming that the proposed changes were reasonable, desirable and consistent with the fiduciary responsibility of the Board to maximize returns while appropriately managing risk.

SWIB has a long and proud tradition of producing excellent returns for the beneficiaries of the funds it invests. Over the years it has become well respected as a public institutional investor that thoughtfully determines investment strategies giving appropriate consideration both to the potential for returns and the degree of risk to be incurred. Passage of the bill pending before your Committee will enable the Board and its professional staff to selectively implement new strategies and use new instruments that can help it continue to be successful in the new, increasingly competitive investment landscape. I strongly encourage you and other committee members to support this bill.

Unfortunately, I will be out of the Madison area at the time of your Committee hearing. Should you have any questions, however, you may feel free to call me at 608-444-4683.

Thank you very much.

Sincerely,

David Mills

Former Executive Director

State of Wisconsin Investment Board

792 Whispering Oaks Road

Oregon, WI 53575
